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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

INDIANA BROADCASTING CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF OF THE NATIONAL ASSOCIATION OF BROADCASTERS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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This brief *amicus curiae* is submitted, on consent of both parties, by The National Association of Broadcasters ("the Association"), a non-profit organization of radio and television broadcasters, whose membership includes, as of a recent date, 455 television stations, 2132 AM radio stations, 906 FM radio stations, and all of the radio and television networks.

The Association is gravely concerned about the fairness of requiring broadcasting businesses owning network affiliation contracts to pay income tax on revenue attributable to recovery of the cost of their major productive asset, while other industries are protected by depreciation allow-

ances on their productive assets. It files this brief, *amicus curiae,* deeply convinced that the decision of the Court of Appeals is in error and, if allowed to stand without review by this Court, will leave the broadcasting industry unfairly discriminated against with respect to other industries.

The Association respectfully urges the Court to take the opportunity now presented by the complete record, which both parties to the pending case have had prepared, to make a final determination which will provide taxpayers, the Internal Revenue Service, and the lower courts with meaningful guidance in the numerous cases presently pending throughout the country, which involve the depreciation of network affiliation contracts (see Petition, p. 15, n. 13). The Association also submits that a review and determination of this issue by the Court will eliminate an unwholesome and widely prevailing uncertainty in many other segments of the national economy in which contractual rights constitute a major source of revenue (see *id.*, n. 14).

The Questions

1. Whether the taxpayer, which has purchased a business contract having a fixed initial term and a probability of renewal for additional periods of time the life of which is uncertain yet capable of being estimated by methods found reasonable by the Tax Court, can depreciate the cost of such an asset.

2. The fairness of either a rule of law or an administrative practice which denies the depreciation allowance to broadcasting businesses on a clearly terminable asset, namely, the network affiliation contract, and yet allows it to many other businesses on assets of terminable yet uncertain life, the duration of which, for depreciation pur-

poses, is determined, under Treasury regulations and court decisions, on the basis of estimates and the general experience of the industry.

3. Whether the Court of Appeals met proper standards for appellate review in setting aside the unanimous finding of the Tax Court, based on extensive consideration of complicated technical and economic facts, that placing an estimated useful life of 20 years on a network affiliation contract does provide a reasonable basis for depreciating such an asset.

Significance of the Questions to the Broadcasting Industry and the National Economy

The specific facts of the controversy which this Court is being asked to review are clearly set out in the petition of Indiana Broadcasting Corporation. The Association would like to bring to the Court's attention these more general implications to the broadcasting industry and the national economy:

1. From a handful of stations immediately after World War II, the television broadcasting industry has grown to a present total of 554 stations, of which only 15 are owned by the three national television networks. For the year 1962, the industry's gross revenues from sales of network and non-network time exceeded one billion dollars and has increased since. The programs which these stations have brought to the public have resulted in a level of production of television receivers which has now attained sales of approximately one billion dollars per annum. The messages brought to the public by these stations have become a marketing force of profound influence on the entire economy.

2. On a national level, industry statistics compiled and published by the Federal Communications Commission for

1962 indicate that television stations not owned or operated by networks enjoyed *local* time sales of $628,000,000 as against $165,800,000 received by those stations from the three national television networks and miscellaneous regional networks. This local revenue cannot be disassociated, however, from network affiliation. Indeed, except for non-affiliated stations in those relatively few markets in which there are four or more television stations, the supply of network programming under affiliation agreements is the most dominant factor that enables television stations to achieve the level of gross revenue attributable to non-network time sales. This phenomenon is accounted for by the fact that both national and local advertisers contracting directly with local stations measure their value by the audiences attracted by network programming and, other things being equal, generally seek placement of their advertising messages in or adjacent to popular network programs (see, *e.g.* R. 95-98, 113-116, 141).

The chief function of an affiliation contract from the standpoint of the station does not lie in the revenues which flow to the station from the network sponsors. Instead, it lies in the programs that the contract supplies to the station. These programs attract and maintain large audiences and thereby enable the station to produce large revenues from the sale of spot announcements in the time intervals between such programs (R. 111-112). Non-affiliated stations are unable to command even a major fraction of the rate for spot announcements charged by network affiliates in the same market.

The inpact of network affiliation on the economics of television station operation is not reflected solely in gross revenues. The average commercial station today is on the air approximately 109 hours per week, or 5600 hours during the year. The enormity of the problem of obtaining programs to fill this time is indicated by the fact that this represents more than ten times the current annual

output of the entire motion picture industry in the United States. In making programs available to their affiliates, networks aid the stations to fulfill their obligation to the community to present a balanced program schedule. Although a network is in one sense an agent for sale of commercial time by its affiliates, basically it is their source of supply of a continuing and essential product, i.e., programming.

It is for these reasons that the network affiliation contract looms so large in the economics of television broadcasting and that the selling price of a television station reflects, to a major extent, the value of its affiliation agreement.

In the years 1949 to 1962, 292 changes of ownership or control of television stations requiring Federal Communications Commission approval occurred. Many of these transfers involved debt financing, generally with banks, insurance companies and other lending institutions. The capacity of purchasers to obtain such financing and to pay off indebtedness was and is directly related to the "cash flow" deriving from the operation of the station, i.e., the sum of net profit after taxes, amortization and depreciation. The extent to which depreciation of network affiliation contracts is disallowed, as a deduction for tax purposes, will have the effect of inhibiting such transactions and will necessarily eventuate in a colossal loss of aggregate values for the affiliated stations in operation today.

3. The value, the significance, and the durability of a television network affiliation contract are in no way permanent. The creation of a greater number of television stations will give the networks a wider choice in the selection of affiliates. New sources of program material will develop. The probability of these developments has been spelled out in the record by the petitioner's expert, Tower, who testified to: (1) the long-established policy of Congress

and the Federal Communications Commission to encourage the use of UHF to bring on the air a greater number of commercial television stations; (2) the serious consideration given by the Commission to moving television broadcasting "upstairs" whereby all stations would be transmitting on the UHF band; (3) the advent of pay television; and (4) technological advances, such as program transmission via satellites (R. 122-127).

This Association knows that, in radio, the value and significance of the network affiliation contract diminished with technological progress. This development was described in 1955 by the then Chairman of the Federal Communications Commission in these words:

> "Experience has shown that the balance of bargaining power shifts from broadcaster to network and vice versa throughout the years. Witness, for example, the present bargaining position in the AM (radio) field. The balance appears to be in favor of the independent broadcaster. Admittedly, the networks presently have the upper hand in the field of television. But with the rapid developments in the art, this may soon change." (Public Notice 27067, Dec. 28, 1955.)

4. There are at least 16 corporations listed on the New York Stock Exchange and others on smaller exchanges which are significantly involved in the ownership and operation of television stations. Continued uncertainty as to the right of these companies to depreciate the cost of their major television broadcasting asset, their network affiliation contract, affects the position of thousands of investors. As this Court has said: "It is the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expense) of the asset to the periods to which it contributes." *Massey*

Motors Inc. v. *United States*, 364 U. S. 92, at 104 (1960); cf. *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, 101 (1943).

Many other corporations in which contractual assets represent a significant portion of total asset value and earning power are also publicly traded. This creates a considerable public interest in having established a final and definite rule as to the proper tax treatment of contractual assets of uncertain but measurable duration, so that the investing public may receive financial statements which dependably reflect earnings.

5. The question presented on this petition is not limited in its ultimate impact to the broadcasting industry alone. Many other industries rely for their continued profitable operation on contractual assurances as to their product supply. These assets may be likened to network affiliation contracts in the uncertainty of their duration, in their impact on the value and financial structure of the business and in the significance of the tax treatment accorded to moneys paid to acquire them. That such guidance is required in other industries, as well as the broadcasting industry, is indicated by but a few of the recently decided cases.*

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* In *Herbert M. LaRue*, 37 T. C. 39 (1961), the Tax Court denied the taxpayer deductions for depreciation of that portion of the cost of an orthodontia practice as was attributable to pending cases. In the same year, 1961, the District Court for the Western District of Texas, in *Johnson* v. *United States* (unofficially reported at 61-1 CCH U. S. Tax Cas. ¶ 9278) held that a taxpayer could depreciate so much of the purchase price for a gynecology practice as was attributable to patients' charts.

In *Thrifticheck Service Corporation*, 33 T. C. 1038 (1960), affd. 287 F. 2d 1 (2 Cir. 1961), the Tax Court held that customers' contracts, bought as a bulk asset, were not depreciable, even where the buyer and seller had taken into account the value and estimated

(Footnote continued on following page)

The Need and the Opportunity for Establishing Certainty

As evidenced by the present record, the cost of a network affiliation contract constitutes a substantial percentage of the purchase price of all the assets of an affiliated television station. The proper accounting as to this substantial item is in suspense (with related effect on dependable profit and loss statements) until certainty is established whether or not this type of asset is depreciable. As specified in the petition of Indiana Broadcasting Corporation, there are a large number of cases involving large amounts of tax liability presently pending in the courts and in the administrative divisions of the Internal Revenue Service awaiting final determination of the questions here presented (Petition, p. 15, n. 13). There are very substantial and far-reaching financial implications in the need also for finality as to whether the substantial amounts involved in the purchase of a network affiliation contract will be capital permanently locked up in the business or will represent a depreciable item that can be recovered over a determinable period.

Both parties to the pending case have prepared a complete record on which the Court can make a final determination. The Treasury Regulations state that when the useful life of an intangible asset (such as a network affiliation contract) "can be estimated with reasonable accuracy" that asset "may be the subject of a depreciation allowance." Treas. Reg. § 1.167(a)-3. (See Petition, Ap-

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(Footnote continued from preceding page)
expiration date of each in computing the purchase price. Yet the Tax Court, in *Savings Assurance Agency, Inc.*, T. C. Memo. 1963-52, allowed a depreciation deduction for the cost of an expiration list acquired from the estate of a casualty insurance agency, and it reached a substantially similar result in *Seaboard Finance Co.*, T. C. Memo. 1964-233, with reference to the amount paid to acquire a small loan business as was in excess of the face amount of the loan contracts and other assets.

pendix A.) Those Regulations also state that, in determining such useful life, "If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination." Treas. Reg. § 1.167(a)-1(b). (See Petition, Appendix A.)

The record in this case brings before the Court all of the economic and statistical data comprising the "general experience in the broadcasting industry" requisite to provide "an adequate basis for making the determination." In *Westinghouse Broadcasting Company*, 36 T. C. 912 (1961), aff'd. 309 F. 2d 279 (3 Cir. 1962), *cert. denied* 372 U. S. 935 (1963), the Tax Court found that "insufficient evidence was introduced from which could be calculated either the average useful life of network affiliation contracts or their usual life span" (36 T. C. at 922). The Court of Appeals for the Third Circuit affirmed, saying:

> "Taxpayer did not adduce any testimony to the effect that based on 'experience' in the television industry the number of renewals of the network affiliation contract could be 'estimated' with 'reasonable certainty' or 'reasonable accuracy' as required by the Treasury Regulations earlier cited." (309 F. 2d at 282.)

The record in the present case was prepared to fill the deficiency of the record in the *Westinghouse* case, so that a final determination might be had (see Tax Court opinion in the pending case, Petition, p. 45a). It is apparent that in the pending case both the Commissioner's office and the taxpayer went to great length and expense to have developed and presented to the Tax Court, as part of a complete record, whatever data might be deemed relevant on the key questions involved. There is an acute need for a final determination of the central question involved and the proper record for such a determination is now before this Court.

The Specific Errors

The Association respectfully suggests that the decision of the Tax Court in the pending case was correct and that the Seventh Circuit was wrong. On the evidence submitted, the network affiliation contracts do have prospective longevity which is determinable with a degree of accuracy as certain as many other determinations of longevity for depreciation purposes which the Internal Revenue Service recognizes. The issue under the Treasury Regulations is whether their length "can be estimated with reasonable accuracy" (Treas. Reg. § 1.167(a)-3).

The Tax Court, "in the light of the evidence adduced by petitioner," was "convinced that none of respondent's criticisms warrant our holding that petitioner's case is so different from that of the general experience of the industry that the useful life or probable number of renewals of its contracts cannot be determined with the degree of accuracy required to permit a 'reasonable allowance' for depreciation." (41 T. C. at 815, Petition, p. 53a.)

To reverse this finding, the Court of Appeals resorted to pure conjectures:

1. That the contracts would be in force indefinitely;
2. That, "unlike an asset having a declining value with the passage of time, these contracts probably will have a constant value, or even an increasing value, in years to come." (350 F. 2d at 586, Petition, p. 15a.)

These conclusions find no support in the evidence and are contradicted by the history of the contracts and by the testimony as to economic and technological trends in the industry.

To arrive at its conclusion, the Court of Appeals set requirements of exactitude and similarity which are at

variance not only with the realities of business experience but with the practice of the Treasury and the holdings of the courts. As to the uncertainty inherent in any determination of estimated useful life, this Court recognizes that "there is a risk of error in such projections, but prediction is the very essence of depreciation accounting." *Massey Motors, Inc.* v. *United States,* 364 U. S. 92 at 105 (1960). The Treasury Regulations covering depreciation of intangibles require only an *estimate,* and that estimate need only have the quality of *reasonable accuracy* (Treas. Reg. § 1.167(a)-3). Yet the Court of Appeals disallowed any depreciation by finding insufficient a degree of accuracy the Tax Court found reasonable on all the evidence.

There is a fundamental contradiction in the decision of the Court of Appeals. On the one hand, it found that "those factors which we hereinafter explore show that each contract is more unique than generic, which makes it questionable whether any meaningful general experience could ever be shown." (350 F. 2d at 583, Petition, p. 9a.)

On the other hand, the Court of Appeals found that, in industry history, "A very high degree of stability is reflected in the history of contracts which have continued in force for more than eight or nine years." (350 F. 2d at 585, Petition, p. 13a.) The taxpayer "purchased the stations with the expectation that the contracts would be continued in force indefinitely. It appears that that expectation will be realized by it in the light of the already substantial duration of the contracts and of pronounced CBS policy governing contract renewals." (350 F. 2d at 586, Petition, p. 15a.)

The Court of Appeals recognized that there is a pattern in the industry statistics which indicates durability. How long a durability? The Tax Court, which bears the primary responsibility for fact finding, determined, on the basis of a complete record, that an average durability of 20 years was reasonable.

The reversal of this finding by the Court of Appeals for the Seventh Circuit adds to the existing haze of uncertainty and conjecture with respect to the depreciation of this increasingly important category of intangible property. The instant case presents an ideal opportunity for the Court to settle the matter.

CONCLUSION

For the foregoing reasons, the petition of Indiana Broadcasting Corporation for a writ of certiorari should be granted.

Respectfully submitted,

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